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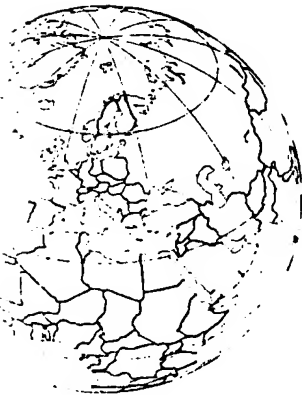
The attached memorandum was prepared by

Security Issues Branch, for

Joseph Halgus of the Office of the Assistant Secretary of Defense for International Security Policy. Requested memorandum was included in Weinberger's Briefing Book for the meeting with the British Defense Minister on 25 October 1985.

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Washington, D. C. 20505

DIRECTORATE FOR INTELLIGENCE

8 November 1985

BRITISH ARMS SALES: TRENDS AND IMPLICATIONS

Summary

A series of recently announced arms sales agreements between the United Kingdom and several Middle Eastern countries will end a four-year decline in British arms sales and bring renewed life to British defense industries. The British position in the international arms market has steadily declined since 1981 and by 1984 Britain ranked fourth in Western Europe behind France, West Germany, and Spain. On top of the recently completed Tornado sales to Saudi Arabia and Oman, the British have negotiated major arms deals with Jordan and India involving ships, planes, missiles, and communication equipment. The successes are due in part to a more sophisticated British sales program combining more attractive financing packages and high-level government support. These new incentives may presage a more aggressive export campaign in other Third World countries. The increase in British export sales will benefit both British industry and NATO purchases of British arms by reducing the unit costs for individual systems, providing a greater return on R&D investment, and, in the case of the Tornado sale, reducing start-up costs for the new European Fighter Aircraft (EFA).

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Declining Arms Sales

For most of the post WWII era, the United Kingdom was among the world's leading exporters of arms, ranking third behind the United States and the Soviet Union. The British global share has declined steadily since the mid-1970s when France overtook the British. By 1984, British arms exports were less than half the level of French exports and even below those of Spain (see Table 1 and figure 1). [redacted]

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Impact on British Industry

The arms export market is critical to the profitability and survivability of British defense industries. British defense industries employ approximately 400,000 workers, and exports traditionally account for over one-fourth of all the military equipment produced, including more than half of the fighter, attack, and trainer aircraft. Sixty percent of total British aerospace manufacturing and one-third of shipbuilding are devoted to military work, including exports. [redacted]

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Declining export sales have led to workforce reductions in certain sectors of the British defense industry and have forced the closing of at least one shipyard. [redacted] Vickers, a tank producer, plans no new hiring and will streamline its current workforce through attrition. The Royal Ordnance factories also will reduce employment once production of gun tubes for Egyptian tanks ends. [redacted] without the recent Tornado sale, as many as 30,000 workers would have been laid off when Tornado production ended. [redacted]

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Arms Customers

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British arms sales are concentrated in a few Middle Eastern and South Asian countries which maintain close security assistance relationships with Britain (see figure 2). India, Saudi Arabia, Jordan, and Oman accounted for just over half of the total military deliveries from the United Kingdom during 1980-1984. Elsewhere, Britain sells military equipment to its European allies and has developed a limited market for its aircraft in Nigeria. The British have also entered into coproduction agreements with US firms for the Harrier jet fighter and Hawk trainer aircraft that promise to bring several billion dollars of defense work to British industry over the next few years. In fiscal year 1984, for example, the United States bought nearly \$500 million worth of British military equipment. [redacted]

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Aerospace and electronics equipment traditionally account for over half of exported British military equipment (see table 2). The Jaguar fighter, Hawk trainer, and Sea Cat and Sea Eagle missiles, for example, have been

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TABLE 1
Estimated Dollar Values of Military Equipment
Provided in 1984

<u>Country</u>	<u>Billion \$</u>
France	3.3
West Germany	2.2
Spain	1.0
United Kingdom	.97
Italy	.95

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Figure 1

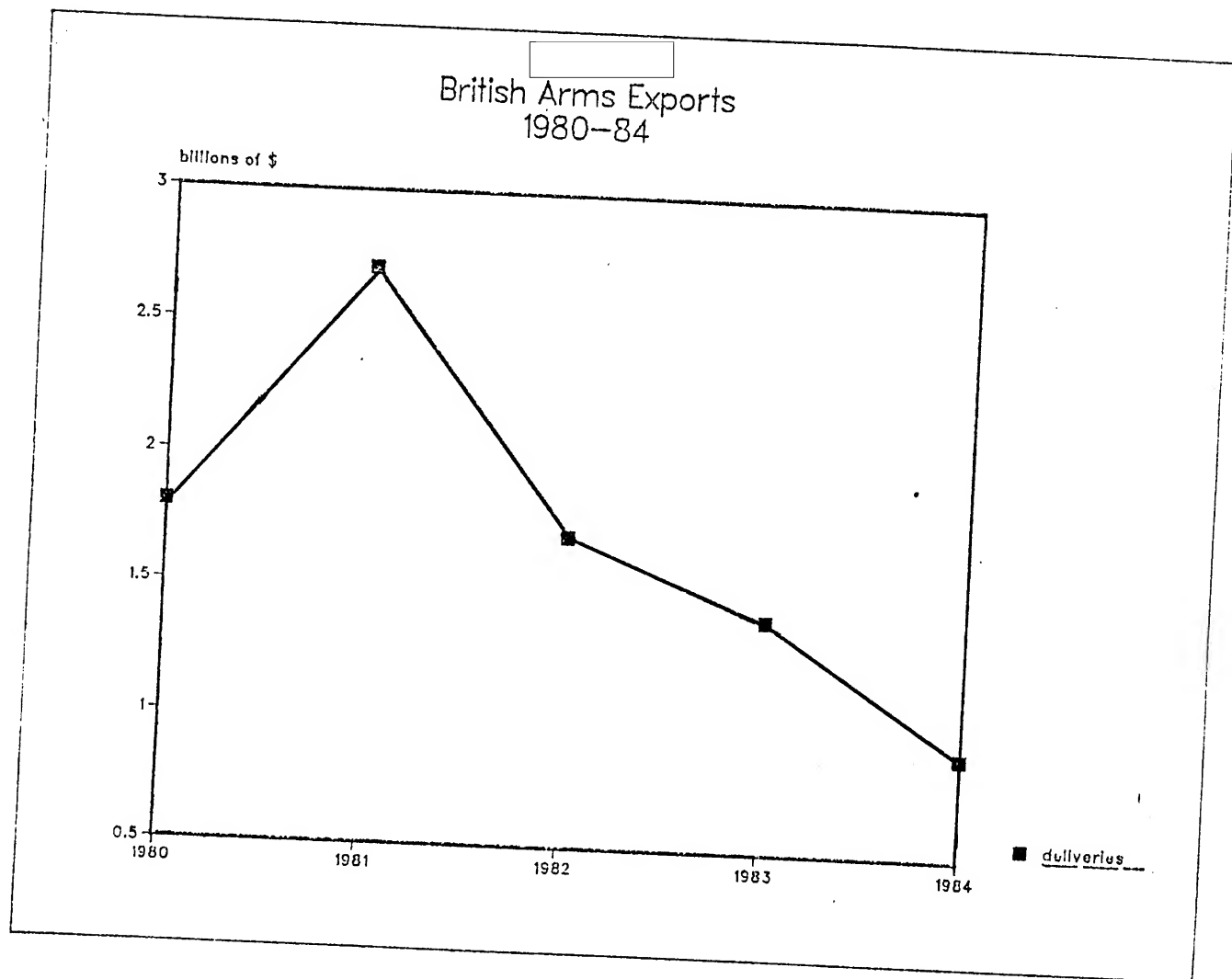


Figure 2

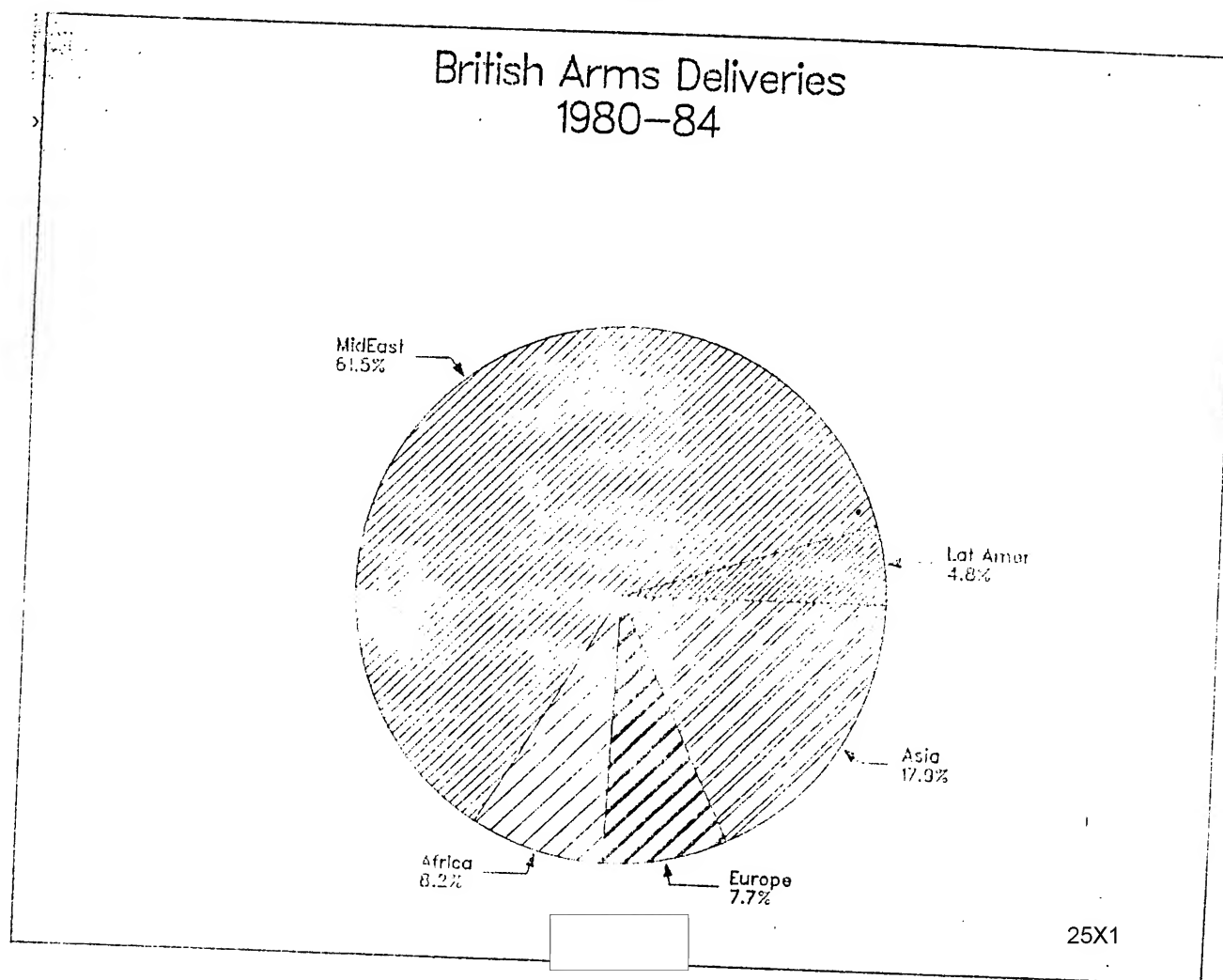


Table 2

MAJOR MILITARY EQUIPMENT DELIVERIES
FROM GREAT BRITAIN
1980 - 1984

<u>System</u>	<u>Number Delivered</u>	<u>Recipients</u>
<u>Aerospace</u>		
Jet Combat Aircraft Jaguar Hawk	117	Finland, India, Indonesia
Transport Aircraft	8	Burkina, Madagascar, Suriname
Helicopters Sea King Lynx Commando	80	Australia, India, Argentina, Norway, West Germany, France, Denmark
Missiles and Launchers Blowpipe Rapier Swingfire	5,891	Australia, Thailand, Qatar, Egypt, Singapore, Chile, Nigeria, Portuga. Norway, Ecuador
<u>Ground Forces</u>		
Tanks Chieftan Vickers	428	Jordan, Oman, Nigeria, Kenya
APCs, AFVs, and, ARVs	516	Malaysia, Nepal, Kenya, Philippines, Sri Lanka, Thailand, Nigeria, Iraq, Tanzania, Portugal, Oman, Ireland, UAE
Artillery Pieces FH-70 105-mm field gun	98	Saudi Arabia, UAE, Ireland, Nepal
<u>Naval Craft</u>		
Patrol Boats	28	Australia, Nigeria, Trinidad, Tobago, Lebanon Saudi Arabia, Oman, Egypt
Mine Clearing Vessels	19	Greece
Frigates	1	Bangladesh

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popular export items. Ground forces equipment--such as the Chieftan, Centurion, and Scorpion tanks and the FH-70 field gun--have played a lesser but still important role, representing between 15 and 20 percent of annual exports. The British also provide substantial training and support services. In 1982, for example, they signed a \$581 million contract with the Saudi Air force for training and maintenance. [REDACTED]

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Recent Successes

The recent large sales of British equipment reflect a continuing reliance on their primary export markets rather than a major expansion into new markets.

- India has agreed to purchase the aging aircraft carrier Hermes--which will be overhauled by British firms--plus 11 Sea Harriers and 26 Sea Eagle anti-ship missiles for \$316 million.
- The recent deal with Saudi Arabia involves 72 Tornado fighters and 30 advanced Hawk trainers for \$5.6 billion. British industry will receive approximately \$3.6 billion from the Saudis with the remainder going to Britain's West German and Italian partners in the Tornado program. Support packages, including spares, technical assistance, and service over the life of the aircraft will generate another \$5 billion.
- In Jordan, the provision of \$360 million in military equipment for the most part supports British equipment already in Jordan, and may include a training package similar to those regularly provided Saudi Arabia. [REDACTED]

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A more sophisticated defense sales effort and aggressive, personal lobbying for the sales by Prime Minister Thatcher were responsible for many of the recent successes and may continue to help exports. [REDACTED]

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[REDACTED] Rigid financing and high unit costs in the past have made British military equipment unattractive to financially constrained Third World countries. And according to attache and press reports, the Prime Minister's personal salesmanship played a key role in winning the Saudi aircraft deal and also helped close both the jet fighter deal with Oman and the Jordanian arms package. [REDACTED]

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British industry still must overcome several weaknesses before it can return as a viable, long-term competitor with other Western suppliers. The recent sales indicate Britain has not broadened its narrow customer base.

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France and Italy, for example, make sizable sales in Latin America, East Asia, and Africa in addition to the lucrative Middle Eastern market. The new British pricing discounts and financing packages may increase their competitiveness in these markets. Nonetheless, British industry continues to design and develop equipment primarily suited for use on the European battlefield, and has not begun to tailor its weapon designs for Third World use as have both France and Italy. [redacted]

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Implications for the United States

Continued British aggressiveness, particularly in courting the Middle Eastern arms market, could present a serious challenge to US industry. Recent sales suggest that Middle Eastern countries are attempting to diversify their Western arms purchases to avoid an overdependence on the United States. According to press and attache reporting, many Middle Eastern customers view the US arms sale decisionmaking process as overly political and heavily burdened by technology transfer issues that are less a problem with European arms producers. [redacted]

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[redacted] would like to reduce their dependence on the United States, and are attempting to obtain EC credits for the purchase of European weapons systems. London's recent successes could provide the British with incentives to offer the same attractive financing arrangements in future sales to make their high-quality weapons available to other countries that may prefer a non-US supplier for their weapons. [redacted]

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Implications for the British

Using our econometric model of the British economy, we estimate that the \$3.6 billion Tornado sale will have a significant positive effect on the overall economy and employment. We estimate that if the sale had not gone through, 30,000 jobs in the aerospace industry would have been lost, plus another 20,000 to 30,000 laid off from jobs indirectly dependent on Tornado production. The Tornado sale also will boost real GDP about 0.4 percent, and the trade balance should improve by about \$0.3 billion. If UK arms sales reach \$8 billion in a three-year period, as the press has speculated, the economic effects would be roughly double those of the Tornado sale. [redacted]

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The recent export successes will also help to stem the growing costs of British weapon systems to other countries and may enable the Ministry of Defense to preserve procurement programs in the face of tighter budgets. Higher production runs will lower unit costs and allow for the recovery of R&D costs. In the case of aircraft, for example, the equipment purchaser pays a unit manufacturing cost plus a proportional share of the total R&D cost of the aircraft. The R&D costs are divided over the projected total quantity of aircraft to be produced. When additional aircraft are sold, each buyer may receive, as a refund, a portion of its original R&D costs.

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R&D expenditures make up about 11 percent of the UK defense budget and represent important seed money necessary to keep design teams together and develop new weapon systems. [REDACTED]

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Finally, the recent Tornado sales should keep Panavia's Tornado production lines open until the new EFA takes its place in the early 1990s. With the transition to EFA, Panavia's facilities will have to be retooled but other potentially large start-up costs, including training skilled workers, should be reduced. [REDACTED]

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* BOX *
* BRITISH ARMS SALES POLICY *

Because arms exports are critical to maintaining the United Kingdom's defense industrial base, domestic political and economic considerations often outweigh strategic concerns in London's arms sales decisions. Criteria for individual sales include the character of the client regime, its record on human rights, and the impact of the proposed sale on the regional balance of forces. These factors, however, seldom override the potential technological, economic, and employment benefits to the United Kingdom. In 1983, for example, London refused to restrict the delivery of sensitive electronic warfare equipment to the Argentine Navy, which had ordered the equipment prior to the Falklands conflict. Moreover, despite Chile's widely recognized human rights violations, London in 1982 lifted its embargo on military sales to Chile, and Santiago currently ranks as the largest buyer of British arms in Latin America. [REDACTED]

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The Thatcher government actively encourages foreign arms sales through a customer-oriented approach emphasizing commercial benefit to British industry. Sales are promoted by the Defense Sales Organization (DSO)--a governmental body under the Ministry of Defense--which exerts substantial influence throughout the British defense industry. [REDACTED]

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philosophy of DSO is to satisfy the customer and, relative to the United States, Britain has fewer legal, contractual, or legislative constraints on defense sales and on technology transfer. [REDACTED]

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